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# **CONTINGENT CONTRACTS: A TOOL FOR FACILITATING THE NEGOTIATION AND MANAGING RISKS. THE CASE OF AN INTERNATIONAL SALE OF GOODS FROM PORTUGAL TO BRASIL.**

## **Abstract**

International businesses bring with them additional negotiation complexities and extra risks, thus calling for negotiation integrative solutions and additional legal protection. The recent economic crisis forced, companies, including SMEs, to look for international markets and face these additional complexities and issues. In the search for a practical and simplified solution, to serve less sophisticated companies, this paper brings insights from the negotiation literature to a specific legal issue. Specifically, I investigate the negotiation and use of contingent agreements as a tool for facilitating the negotiation process and managing risk in international deals. Looking into an international sale of goods from Portugal to Brazil, this paper proposes the structuring of two contingent contracts related to two category of products in order to demonstrate the potential benefits of some of its relevant features, specifically the creation of incentives and identification and allocation of future risks. In general, the structuring of contingent agreements is likely to provide positive results in mitigating the issues of lack of trust and dealing with the additional risks derived from international deals, therefore facilitating and improving the overall quality of the deal.

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## 1. INTRODUCTION

In negotiations, business managers mostly rely on a context defined by market practices within the sectors they operate, which in the case of an international deal is different and strange to the negotiating parties. Moreover, parties in international deals are from different countries with different legal systems and different cultures. As someone may expect, these factors will add significant complexity to the negotiation process and potentially involve a conflict of two legal systems. This may represent a lower probability of closing deals and a higher probability of disputes, besides the extra legal risk.

The effect of these negotiation and legal complexities must be especially problematic for less sophisticated companies, meaning companies that operate internationally without the appropriate negotiation and legal competences or professional support. It is here assumed that this legal unsophisticated group of companies is in its majority represented by SMEs<sup>1</sup>, which due to their size and volume of business usually lack the necessary competences for international deals or face financial restrictions to support the expenses of professional and specialized help.

This paper advocates that managers of SMEs usually see the law and legal services as solution to disputes, such as mediation, arbitration and court procedures. In this respect, the application of the law becomes subsidiary and serves solely as remedy, only relevant when a dispute arises. However, the use of a well designed and detailed contract<sup>2</sup>, which promotes the use of the law as prevention of disputes, is a prerequisite for the effectiveness of some advanced negotiation techniques. Therefore, poorly drafted contracts presupposes that parties are ignoring the use of advanced negotiation strategies, which is probably the major factor that leads parties to a future dispute. Without the use of advanced negotiation strategies and their formalization through well designed contracts, parties risk closing fewer deals, leaving money on the table and increasing their exposure to risks.

Again, this unsophistication reflecting on the capability of these SMEs of negotiating well-designed contracts will endanger the success and sustainability of their internationalization process. In this sense, this paper defends that well negotiated and designed contracts, specifically the negotiation and use of contingent contracts (herein after referred as “contingent agreements”), which is analysed in detail below, mitigates the complexities of the international negotiation and significantly reduces the risk of a future dispute, consequently promoting and facilitating the access and success of SMEs in international markets. As this paper will demonstrate, the negotiation and use of contingent agreements can be simple and accessible to less sophisticated companies, and could still produce positive results.

Due to the complexities mentioned above, in the past and during good economic times, when the local market presented enough demand, business opportunities in the international

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<sup>1</sup> Small and Medium Enterprises.

<sup>2</sup> In this sense see the term “contract embellishment” defined by RAIFFA, 2000.

market were overlooked by current exporting SMEs. For simplicity, it is natural that local business deals are the first choice of SMEs. In order to support this rationale, the number one client of Portugal, representing around 20% of Portuguese exports of services and goods, is Spain, which is probably the least complex international option on the table for Portuguese exporting companies<sup>3</sup>.

Appointed by the Portuguese Trade Agency - AICEP<sup>4</sup> in its guide for the internationalization of SMEs<sup>5</sup>, the recent economic crisis resulted in a significant decrease in local demand and consequently forced companies, including SMEs, to look for international markets. Therefore, the targeting of international markets potentially became a matter of survival for several SMEs<sup>6</sup>, and consequently dealing with the negotiation complexities and extra legal risk intrinsic to international deals represents now a necessity for the success and sustainability of their internationalization process.

For this reason, this paper uses the recent fast growth of exports from Portugal to Brazil in the last years (see section 3.1) and the recent Brazilian adoption for the text of the Convention on Contracts for the International Sale of Goods (CISG)<sup>7</sup> (see section 3.3.1) as an opportunity to review and promote the use of contingent agreements by SMEs in order to overcome some of the extra complexities of international business deals resulting from lack of trust, by the creation of incentives and managing risk and by the avoidance of future disputes. Using the example of hypothetical international sale of goods from Portugal to Brazil, and after a brief legal review, this paper also proposes the structuring of two contingent agreements related to two categories of products.

## 2. CONTINGENT AGREEMENTS AND ITS FEATURES

### 2.1. Overview

Contingent agreements, as the name defines, deal with terms that are not final<sup>8</sup>. Contingencies are conditions dependent on the occurrence of a future and uncertain event. For negotiation and legal contracting, contingencies are structured through a contract clause that defines a course of action, such as an obligation to perform a payment upon the occurrence of a future and uncertain event. In practice, all sorts of events related to the performance of a

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<sup>3</sup> According to information from a report prepared by AICEP, updated up to November 2013, with the source from Fonte: INE - Instituto Nacional de Estatística; Banco de Portugal Notas e siglas, available for download at the digital library of AICEP web address: <http://www.portugalglobal.pt/PT/Biblioteca/Paginas/Homepage.aspx>

<sup>4</sup> The Portuguese Trade & Investment Agency (AICEP) web address at: <http://www.portugalglobal.pt/>

<sup>5</sup> “*Horizonte Internacionalizar*”- Internationalization guide for SMEs from the Portuguese trading agency AICEP. Chapter 1, page 26 second paragraph.

<sup>6</sup> Ibid – Chapter 1, page 26 second paragraph.

<sup>7</sup> The Convention on Contracts for the International Sale of Goods (CISG) of 1980 prepared by UNICTRAL available for download at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/sale\\_goods/1980CISG.html](http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html). Also visit the webpage of the Institute of International Commercial Law of the Pace Law School with a vast repertoire of supporting materials for the CISG at: <http://www.cisg.law.pace.edu/>.

<sup>8</sup> “*Contingent contracts are if-then agreements that specify conditions under which specific actions will apply in specific outcomes*”. THOMPSON, 2008.

business deal could be considered future and uncertain, thus representing economic risks for the parties involved. These additional risks derived from future and uncertain events should be allocated to parties in order to avoid future disputes, a task that must be the object of the negotiation process before closing the deal. The effectiveness of this negotiation process depends on the previous use of integrative negotiation techniques and its formalization through the structure of a written contract clause<sup>9</sup>. Contingent agreements, in this sense, in addition to being an essential negotiation tool, can also function as a risk management facility<sup>10</sup>, as discussed in more detail in section 2.3 below.

The use of contingent agreements is considered a type of integrative negotiation strategy. Basically, there are two general categories of negotiation strategies, distributive and integrative strategies: dividing the pie and enlarging the pie, respectively (THOMPSON 2013). In relation to a negotiated agreement, distributive strategies regard the competition between the parties for dividing value and integrative strategies regard the cooperation between parties for creating additional value. Note that the value that is created under integrative strategies must also be distributed in between the parties, thus distributive strategies are essential to the negotiated agreement. However, as discussed below, the use of contingent agreements, as a form of integrative strategy, is likely to avoid a bitter discussion over value distribution, because it deals with expected value and risk based on parties' individual perceptions and expectations, potentially relying on parties' biased opinions about future and uncertain events.

The fundamentals for integrative negotiation strategies are that parties have different interests<sup>11</sup> and consequently the expected value they attribute to conditions of their negotiated agreement could significantly differ. Besides different interests and expectations, parties may have different valuations, aversions to risk, time preferences, access to privileged information and other differences (THOMPSON, 2008 and 2013. See also FISHER, URY and PATTON 1991) that, although apparently representing obstacles to a negotiated agreement, under the use of integrative negotiation strategies become opportunities for creative solutions<sup>12</sup>. Considering the international character of the business deal, these differences must be more apparent, consequently adding extra complexities, but on the other hand, providing more opportunities.

The information about these differences is usually confidential, thus the use of integrative strategies requires cooperation by the negotiating parties and possibly disclosure of some sensitive information. However, before parties can build trust, revealing sensitive information is dangerous and may put the negotiator in a weaker position. In this respect, the use of contingent

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<sup>9</sup> Formalization of contingent contracts in written contracts with the appropriate legal counselling is one of the requirements for its effectiveness. THOMPSON, 2008.

<sup>10</sup> Risk managing is in line with the provisional character of contingent agreements. "*Contingency contracts are agreements that leave certain elements of the deal unresolved until uncertainty is resolved in the future.*" MALHOTRA and BAZERMAN, 2007.

<sup>11</sup> For a real and interesting case and proof of different interests and valuations of negotiating parties see the case of the red paper clip work project of Kyle MacDonald at his blog web address: <http://oneredpaperclip.blogspot.pt/>

<sup>12</sup> In this sense see the Key role of differences on page 90 and following, Chapter 5, LAX and SEBENIUS 1986.

agreements is likely to avoid the disclosure of sensitive information, facilitating the closing of deals. As a result, negotiating contingent agreements may also avoid future disputes, a direct result from negotiating *ex ante* and promoting contract performance by the creation of the right incentives. Therefore, the need for the use of contingent agreements is strongly relevant and recommended, especially in international deals for the reasons here explained.

Although contingent agreements are very useful and most business managers are aware of their existence and rationale (contingent contracts are in common terms defined as “bets” by negotiation literature), SMEs managers may just ignore the need for their use (FISHER, URY and PATTON 1983) or the legal necessity of a written format (THOMPSON 2008). Considering the lack of sophistication of SMEs, it is usual for parties to ignore the negotiation of essential clauses such as the “choice of law”, most of the time left to default rules<sup>13</sup>, a fact that supports the argument that the structuring of contingent agreements is also unknown or ignored in the majority of the cases.

## 2.2. Requirements for effectiveness

It is true that some situations may require the use of more advanced techniques and some level of legal experience, but simple forms of contingent agreements already bring value to the table in terms of facilitating the negotiation process and managing risk. In fact, the structuring of this sort of agreement could be made simple and practical without losing its strength and effectiveness. In this regard, negotiation scholars identify several requirements for the best effectiveness of contingent agreements, which are here reproduced and commented for a matter of opposing any argument in favour of complexity:

- The objectives for each party involved must be aligned (THOMPSON 2008, p. 124). Since this is one of the features of contingent agreements, it should not be considered a requirement for effectiveness. I suggest that if parties create the right incentives, their objectives will be aligned. Therefore, incentives to be created are the real concern.

- The promise is based on an uncertain event: the action required of one party is only dependent upon the occurrence of some event in the future (SHARMA 2004, p. 87). This is the essence of contingent agreements, and is therefore not considered a requirement for effectiveness;

- The event must be “minor” to the contract: the performance of a promise is not the event; rather it is part of the contract (SHARMA 2004, p. 87). This statement is not necessarily true. *Swap contracts*<sup>14</sup> are a form of contingent agreement and represent the whole essence of

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<sup>13</sup> See the CISG study performed by CUNIBERTI 2006.

<sup>14</sup> Swap contracts are usually used by Financial Institutions to hedge exchange and interest rates risks, or maybe speculate and invest over future and uncertain events. These contracts if subject to court review may be deemed void. Please see the article mentioned in the footnote below.

the contract. However, if the contingent agreement somehow represents the whole purpose of the deal, this deal may be considered a game, which is illegal in Portugal and Brazil<sup>15</sup>;

- The event is independent of the promising party: the occurrence of an event is not controlled by the promising party's will or desire (SHARMA 2004, p. 87). The problem here may not be actually about the control over the outcome, but in fact and again the incentives created by contingent agreements. In this regard, if the promising party has control over the outcome but at the same time has the incentive to perform according to the contract this should not be a concern. In this regard, it is also possible to create benefits for both parties under a contingent agreement, thus avoiding this sort of concern;

- The agreements should be formalized in writing with appropriate legal counsel (THOMPSON 2008, p. 124). Otherwise, if the agreement is not in writing the parties may forget or deny the terms of the deal. It is important to remember that the future and uncertain event that would trigger the contingent agreement may happen very distant in the future, which brings risks not only from people's limited capacity to remember but also potentially from changes in personnel and management;

- The parties must mutually decide how the terms of agreement will be measured (THOMPSON 2008, p. 124). In fact, there is a stronger requirement in this respect. The terms of the contingent agreement should leave no room for different interpretations; therefore, the measurement procedure must be objective and clear as possible.

In summary, this paper argues that there are three basic and essential requirements for the good use and effectiveness of contingent agreements: a written format; the creation of the right incentives, and objective measurability and criteria (FISHER, URY and PATTON 1991 Chapter 5). The written format and objective measurability play similar roles in documenting and protecting the terms and positions taken by parties during the negotiation. The absence of a written format and/or the subjectivity of the defined terms significantly reduces the enforceability and effectiveness of contingent agreements. But most important are the incentives created by the contingent agreements. In this respect, the contract becomes the law between the parties (see the concept of party autonomy discussed in section 3.3) and an external effect of this law<sup>16</sup> is the incentives it gives to parties. So parties must make sure they create the right kind of incentives, in order to avoid conflict of interests.

### 2.3. Features of Contingent Agreements

It is natural that companies in a business deal have different interests, sometimes even conflicting interests. According to negotiation scholars (THOMPSON 2013), parties when negotiating a business deal may have the following differences: i) Differences in the valuation of

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<sup>15</sup> In this respect see the article regarding the validity of *SWAP* contracts in Portugal, a subject recently highly discussed due to the use and consequent big losses of Portuguese companies. FREITAS, José Lebre de., *Contrato de SWAP Meramente especulativo. Regimes de validade e de alteração de circunstâncias(\*)* - Artigo destinado à obra colectiva, no prelo, em memória dos Professores Doutores Palma Carlos e Castro Mendes.

<sup>16</sup> This is similar to the subject of Law and economics, which study the economic effects of laws. See FRIEDMAN, 2001.



the negotiation issues ;ii) Differences in expectations of uncertain events; iii) Differences in risk attitudes; iv) Differences in time preferences; and v) Differences in capabilities. These differences usually represent negotiation obstacles to the majority of business managers, and can even cause the collapse of many business deals (BAZERMAN and GELLISPIE 2009). Through the use of contingent agreements and other integrative negotiation strategies parties can in fact capitalize on these differences (THOMPSON 2013, FISHER, URY and PATTON 1991 and LAX and SEBENIUS 1986).

In this respect, negotiation scholars specify six features of contingency contracts, which result from allowing negotiators to: (1) build on their differences, rather than arguing about them; (2) manage-decision making biases (BAZERMAN 1997); (3) solve problems of trust; (4) diagnose the honesty of the other side; (5) reduce risk through risk sharing; and (6) increase the incentive of the parties to perform (THOMPSON 2013).

Therefore, contingent agreements enable parties to align and overcome their differences, facilitating the negotiation process and avoiding arguments about future, uncertain events. This is mainly done through the creation of “bets”, a feature strongly promoted by negotiation scholars (BAZERMAN and GELLISPIE 2009). The creation of “bets” will potentially avoid biased and indefinite discussions and minimize questions of credibility, by adding the proper incentives to increase performance and protection. In addition, the use of contingent agreements also serves as powerful risk management tool, as discussed in section 2.3.2 below.

According to negotiation scholars (FISHER, URY and PATTON 1991), although not specifically referred to contingent agreements, the value creation in negotiation and reaching of agreements comes from the creation of options by building on the above listed differences between parties. As demonstrated in the literature, ignoring the value creation potential of their differences results in negotiators leaving money on the table. There are substantial opportunities result from negotiating parties realizing that their differences are not obstacles but in fact a prerequisite to design “win-win” negotiated agreements. Once this is understood, through a brainstorm activity, negotiating parties, individually or collectively, can come up with several options to accommodate their differences, facilitating and adding value to their negotiated agreement.

In the context of an international business deal with its additional complexities, from all the features of contingent agreements listed above, this paper will examine in further detail the functions of facilitating the negotiation process and managing risk arguments. The following sections will present the arguments behind the use of contingent agreements as a possible solution to overcome distrust in two ways: first, by avoiding the disclosure of sensitive information and creating incentives for better performance, thus facilitating the negotiation process and as a risk management facility; and, second, by avoiding and restricting future disputes, thus improving the quality of the deal.

### 2.3.1. A possible solution for distrust

An important function of contingent agreements is as a solution for distrust. Distrust is especially problematic in international deals, because of the distance, reciprocal lack of knowledge about the other parties' interests, market practices, and other conditions mentioned before. At the time of the negotiation, parties have not yet developed trust in their commercial and business relationship. The lack of trust can lead to fear of disclosing information and other credibility issues, such as doubting the other party's capabilities to fulfil the contract. The lack of trust can restrict the use of integrative negotiation strategies, which require cooperation and exchange of information (THOMPSON 2013).

Note that differences between parties relate to sensitive information about a company and its strategy in the context of a negotiation. As mentioned, the disclosure of information is sensitive and dangerous, which may leave the negotiator in a weak position. One may assume that many deals are not closed due to lack of trust and consequent perceived risks. This paper refers to trust in a broader sense, also considering cases where parties' different valuations and perceptions lead to suspicion of the other party's information or statements. Therefore, at the beginning stage of negotiation, without trust, parties should consider the use of contingent agreements in order to avoid the disclosure and discussion over sensitive issues, thereby facilitating the negotiation process.

The usual solution for lack of trust and credibility, commonly used in the daily life, is the creation of "bets" regarding promises and responsibilities. Betting on your promises is a way to demonstrate commitment to third parties, backing it up with an incentive to perform accordingly, and assuring the other party of your future effort to overperform (premium clause) or provide compensation for not underperforming (punitive clause). Assuring the other party of your compromise and betting on your promises and responsibilities also promotes contract performance through the creation of incentives (BAZERMAN and GILLISPIE 2009)

The use of punitive or premium clauses functions as contingencies, by representing negative and positive incentives (MALHORTA and BAZERMAN 2007). In this respect, these clauses promote performance and respect of the contract. These incentives may be used solely or in combination. They may also affect one or both parties at the same time. In the example of the contingent agreement proposed below, a dynamic pricing scheme based on quality standard, where the dynamic character of the price serves both parties, functions by ensuring compensation for the seller's investment in better quality and protecting the interests of the buyer in the case of non-conformity.

A premium clause should be dependent on over performance, such as "early delivery", achieving sales quotas, closing deals, and many other potential "If-then" agreements. There may be other more creative conditions for incentivizing over performance. The strength and level of the creative process depends on the negotiators' knowledge of integrative negotiation strategies regarding creative solutions and about their industry. For example, a brainstorming activity

(FIHSER, URY and PATTON 1991), could provide positive results in this regard. Note that this paper assumes parties are reluctant to trust each other, so the brainstorming activity should be done individually and will regard the structuring of contingencies to be proposed to the other party, thereby avoiding direct disclosure of information.

By combining integrative negotiation strategies and industry knowledge parties are equipped to design all sorts of contingencies. For example, imagine parties to a contract of representation. The seller is concerned about incentivizing the buyer to take good care of the brand. Although the obligation for good performance, including the proper care of a brand, is implicit to the deal, parties in practice respond much better to incentives. For example, parties may include a premium clause depending on the fulfilment of contingencies, such as participation in social events or contributions to ONGs that may strength the brand in the external market.

Moreover, the use of contingent agreements promotes performance also based on parties' psychological commitment. In particular, parties that fully negotiated the terms of the deal are more inclined to perform accordingly than when this course of action is the result of a chosen or defaulted legal system. For example, if parties do not agree on a specific course of action upon the occurrence of a future outcome, in the case of a dispute, the "rights approach" (see section 2.3.2 below) will depend on the rules of the law applicable to the contract and these rules may not serve the interest of the parties. This is based on the principle of party autonomy, explained in section 3.3.2 below, making the contract the law between the parties.

The alternative to negotiating and making use of contingent agreements, can be parties just arguing continually about their differences and suspecting the other party's promises and capabilities, possibly jeopardizing their negotiated agreement. Or they may just leave money on the table and assume risks they were not counting on, as in the case of a dispute and the recourse to the applicable law that may be unknown and not serve the interests of the parties. In this sense, betting over your promises and capabilities through the use of contingent agreements will avoid the disclosure and discussion of sensitive issues and will assure the other party of your commitment, creating an incentive for contract performance, therefore facilitating the negotiation process and the closing of the deal<sup>17</sup>.

#### 2.3.2. A risk management facility

Another feature of contingent agreements that is important in international deals is the management of risk. Future and uncertain events that may economically affect a business relationship represent risks and these risks must be identified and allocated to parties in advance. Imagine for example, a strike and the losses that it may cause, or a change in exchange rates turning the business deal unprofitable for one of the parties. The management of

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<sup>17</sup> "By the same token, contingency contracts build trust and good faith between negotiators because incentives can be provided for each company to deliver exceptional performance". THOMPSON 2008 - Chapter 8 page 189.

risk is especially important in international deals considering the additional complexities mentioned before, therefore further justifying the use of the contingent agreements.

Contingent contracts operate by parties identifying and allocating risks in advance, during the negotiation process. At this time their perception and expectation about the future are different, resulting in different expected values, and enabling the structuring of the contingent agreement, i.e., betting over expectations. Through the *ex ante* identification and allocation of risks related to future and uncertain events, parties exchange and negotiate expectations, which have different values for the parties. On the other hand, when the future and uncertain event occurs expectations do not exist anymore and in the absence of a previous contingent deal, the negotiation will refer to the reality of losses instead of risks, which is both more difficult and more likely to lead to a dispute.

In the case of a future and uncertain event affecting a business deal, parties that did not negotiate a course of action based on their expectations, will have to dispute who will bear the responsibility. This requires a review of how the respective risks were allocated, which is already basis for disagreement. That is because these risks were previously not thought off, nor allocated, nor negotiated by the parties. This will certainly lead parties to distress, as the situation moved from a negotiation to a dispute. This is especially important in the case of a supply contract with many instalments, where a dispute in relation to any specific instalment can potentially disrupt the whole agreement.

In addition, in the absence of a negotiated contingent agreement allocating the potential future risks, when a future risk materializes and becomes a real cost, parties in dispute over the cost will potentially bring to the table all sorts claims and arguments unrelated to that event. In other words, it will open the door for the parties to use all their arguments, including past events, in order to avoid taking responsibility for this unexpected costs. Even if parties reach a deal during this dispute, the business relationship can be damaged. On the other hand, if parties have a contingent agreement identifying and determining a course of action when this future and uncertain event materializes, a dispute should only arises in the case of default and non-performance by the responsible party. In that case, only arguments related to the breach of that contingent agreement should be considered relevant. This will limit the scope of discussion of a given dispute, facilitating a deal. Even in the case of a legal dispute, the legal discussion in court will take into consideration the intent of the parties based on the terms of the contingent agreement. This is the case even if the contingent agreement becomes void under the law governing the contract, thus also limiting the scope.

Note that there are contract clauses related to future and unexpected risks, usually denominated “hardship”<sup>18</sup>, that may give the power to parties to bring all sorts of arguments and

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<sup>18</sup> Hardship clause is a clause in a contract that is intended to cover cases in which unforeseen events occur that fundamentally alter the equilibrium of a contract resulting in an excessive burden being placed on one of the parties involved. See also Melis, Werner, Force Majeure and Hardship Clauses in International Commercial Contracts in View

renegotiate the whole agreement, including the price and other conditions. Another contract clause that may affect the use of a contingent agreement is the force majeure<sup>19</sup>, which refers to events of nature beyond the control of the parties that may change the economic balance of the contract. However, in the presence of a contingent agreement, it may be difficult to accept claims of hardship or force majeure<sup>20</sup>.

Moreover, in the case of a dispute, the terms of the contingent agreement besides limiting the scope, will support parties' arguments under the "Rights approach" in the case of dispute, which is alleged to provide better and fair results (URY, BRETT and GOLDBER 1988). Negotiators can use three different approaches in a dispute process: Interests (integrative), Rights (based on the contract or the law) and Power (based on status, rank, intimidation and threats) (THOMPSON 2013).

Focusing on interests is usually the best alternative. By focusing on interests during a dispute, parties can make use of integrative strategies to reconcile the issues that caused the dispute. Again, this integrative negotiation process requires cooperation, exchange of information, and trust. By the time a dispute arises, parties may have already developed trust in their commercial relationship and this approach is feasible. Instead of enforcing the contingent agreement, parties may sit and renegotiate a new solution. In this respect, the existence of a contingent agreement does not invalidate the right of the claiming party to forgive the other party and reconcile through a new agreement. As mentioned below, contracts are dynamic and evolve over time, and at the time of a dispute it may be better to renegotiate than enforce the contingent agreement that triggered the dispute.

Again, the principle of party autonomy will protect what parties have negotiated and define in their contracts with the force of law. The existence of a contingent and specific agreement will also put the burden of proof on the non-performing party, which will be limited to argue over lack of intent and other technical legal claims of invalidity, trying to invalidate the terms of the contingent agreement. In this respect, it comes the requirement for an objective and crystal clear measurability of the contingencies, a requirement for its effectiveness defended above, which serves to avoid doubts and different interpretations when the future event occurs.

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of the Practices of the ICC Court of Arbitration, 1 J.Int'l Arb. 1984, at 213 et seq. Available for consult and download at: <http://www.trans-lex.org/126600>

<sup>19</sup> "Force majeure or vis major (Latin) "superior force", also known as cas fortuit (French) or casus fortuitus (Latin) "chance occurrence, unavoidable accident", is a common clause in contracts that essentially frees both parties from liability or obligation when an extraordinary event or circumstance beyond the control of the parties, such as a war, strike, riot, crime, or an event described by the legal term act of God (such as hurricane, flooding, earthquake, volcanic eruption, etc.), prevents one or both parties from fulfilling their obligations under the contract. Definition provided at [http://en.wikipedia.org/wiki/Force\\_majeure](http://en.wikipedia.org/wiki/Force_majeure).

<sup>20</sup> "Hardship clauses typically recognize that parties must perform their contractual obligations even if events have rendered performance more onerous than would reasonably have been anticipated at the time of the conclusion of the contract. However, where continued performance has become excessively burdensome due to an event beyond a party's reasonable control which it could not reasonably have been expected to have taken into account, the clause can obligate the parties to negotiate alternative contractual terms which reasonably allow for the consequences of the event." Comments on [http://en.wikipedia.org/wiki/Hardship\\_clause](http://en.wikipedia.org/wiki/Hardship_clause).

If parties negotiated and made use of contingent agreements, when a dispute arises in relation to the non-performance of one of these contingent agreements the claiming party has two options: 1) focus on interests, do not enforce the agreement and renegotiate a new deal, or 2) focus on rights and enforce the agreement, through mediation, arbitration or court procedure. Both renegotiating and enforcing the agreement can reinforce trust between parties. Also, in both cases, the claiming party is better off than having no contingent agreement at all and having to resort to the power approach if reconciliation is not achieved. In the context of an international business deal, the use of the power approach against a written agreement previously negotiated by the parties shows bad faith by the party at fault. This is an issue that the use of contingent agreements does not solve completely. The only option in this case is to resort to court or arbitration methods of resolving disputes that are regulated and protected by law<sup>21</sup>. Therefore, the negotiation and use of contingent agreements will avoid the power approach, serving as a filter and detection of bad deals (THOMPSON 2013 - Chapter 8, page 189), in order to manage risk<sup>22</sup>.

Thus, the negotiation and use of contingent agreements serves as a risk management facility for three major reasons: i) Avoiding disputes. The process of previously identifying, negotiating and allocating risks through contingent agreements based on parties' expectations avoids future disputes; ii) Restricting the scope of disputes. Disputes will arise in relation to a breach of a contract clause restricting the scope of discussion. Only arguments in relation to the clause should be considered relevant; and iii) Avoiding the use of the power approach, reinforcing trust in between parties.

### 3. THE USE OF CONTINGENT AGREEMENTS IN INTERNATIONAL SALES OF GOODS FROM PORTUGAL TO BRAZIL

A review of negotiation relating to contingent can benefit from application to a specific context. In the present case, we focus on an international business deal. The type of contingencies and their structuring will vary from industry to industry, country to country, depending on local regulation and market practices. Given the recent fast growth of exports from Portugal to Brazil (see section 3.1) and the adoption of the CISG by Brazil (see section 3.3.1), I specifically look at international sale of goods from Portugal to Brazil. The analysis can be useful to promote the access and exploration of the Brazilian market by Portuguese companies, assumed to include a large numbers of SMEs<sup>23</sup>.

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<sup>21</sup> Parties cannot use the power of the state (usually referred as "power of police") to enforce a decision made by a mediator. Only decisions from an arbitrator, according to the arbitration rules of the New York Convention (<http://www.newyorkconvention.org/>) when the countries in cause are signatories (Portugal and Brazil are signatories of the NY convention on arbitration) or court decisions of the tribunal that has jurisdiction over the case are subject to enforcement through the power of the state. Therefore, these are the only two system of resolving dispute that may considered legal.

<sup>22</sup> "Therefore, contingency contracts provide a safety net, limiting each company's losses should an agreement go awry unexpectedly." THOMPSON 2013.

<sup>23</sup> According to a report of the company Informa D&B, dated January 2013, based on information of the IES (*Informação Empresarial Simplificada*) of the year of 2011, from the total portfolio of Portuguese companies, 85,9% are micro and

### 3.1. The trade relation of Brazil and Portugal

The commercial relationship between Portugal and Brazil can be traced back more than four centuries. The early history and same language led to intensive periods of migration in between these countries. There are about five million people direct descent of Portuguese living in Brazil. This suggests the psychological and historical proximity of these countries and the resulting potential of the Brazilian market for Portuguese exports. These countries maintain close economic and political relations, both being founder members of the Community of Portuguese Speaking Countries and parties to several bilateral and multilateral agreements concerning tourism, tax, employment, industrial and commercial cooperation and social security. With so much in common one should expect a large trade balance in between those countries.

A 2012 report issued by the Portuguese Trade & Investment Agency (AICEP)<sup>24</sup>, which analyses the economic evolution of the trade balance in between Portugal and Brazil, points to a significant increase in Portuguese exports to Brazil. From 2007 to 2011, Brazil moved from rank 17th to 10th, becoming a top ten client of Portuguese exports. AICEP data also shows that this increase in trade relation can be explained by the effects of the recent economic crisis, resulting in a significant decrease in local demand (Portugal and Europe) and forcing Portuguese companies, including SMEs, to focus on international markets. This fact supports the argument that SMEs cannot escape from international deals and therefore need the benefits of advanced negotiation strategies, such as the contingent agreements here proposed. In this sense, despite its recent growth, data shows that the trade balance is still far below its potential. According to the same report, in 2011 Holland and Belgium exported three times more to Brazil than Portugal.

### 3.2. Setting the parameters of the international sale of goods

Although some of the findings here may be applicable to other international deals, and also to the export of other products or even services, for the purpose of proposing practical applications in section 4, the focus of this research will be on the export of agricultural and alimentary products from Portuguese companies to the Brazilian market.

The choice for these categories of products<sup>25</sup>, agricultural and alimentary, is justified by their importance to the Luso Brazilian trading, representing in 2011 respectively 37,5% and 6,9% of total exports of products. In addition, it is also assumed here that these are industries with high concentration of Portuguese exporting SMEs.

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11,9% are small. Therefore, one may assume that several SMEs are exporting and internacionalizing to Brazil and could make good use of the contingent agreements here advocated.

<sup>24</sup> This document is available for download at the webpage of the Portuguese Trade & Investment Agency (AICEP) at <http://www.portugalglobal.pt/PT/Biblioteca/Paginas/Homepage.aspx>

<sup>25</sup> See [http://en.wikipedia.org/wiki/Combined\\_Nomenclature](http://en.wikipedia.org/wiki/Combined_Nomenclature). “A Nomenclatura Combinada (NC) é a nomenclatura das mercadorias da Comunidade Europeia que satisfaz as exigências das estatísticas do comércio internacional (intra e extracomunitário) e da pauta aduaneira, nos termos do artigo 9º do Tratado que institui a Comunidade Económica Europeia.” Instituto Nacional de Estatística – INE – [www.ine.pt](http://www.ine.pt). Portuguese version: [http://www.ine.pt/xportal/xmain?xpid=INE&xpgid=ine\\_publicacoes&PUBLICACOESpub\\_boui=134210467&PUBLICACOESmodo=2](http://www.ine.pt/xportal/xmain?xpid=INE&xpgid=ine_publicacoes&PUBLICACOESpub_boui=134210467&PUBLICACOESmodo=2) English version: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:290:FULL:EN:PDF>

Agricultural products are subject to weather conditions and consequently may present large variations in quality standards. Parties dealing with the international sale of this category of products will be naturally exposed to variations in quality therefore, in order to facilitate the closing of the deal and manage risk, should negotiate and deal with these issues in their contract of sale. The proposed contingent agreement analysed in detail below, as an attempt to solve this issue, will regard a dynamic pricing scheme, which by reducing price in the case of non-conformity or increasing the price in the case of improved quality can demonstrate some of the features proposed in section 2.

Alimentary products are generally considered fast moving consumer goods and their sales performance is closely connected to marketing, especially with the recent shift of power from producers to retailers (THAIN and BRADLEY 2012). This is the usual impasse in contracts of sale and distribution of consumer goods. The buyer wants more investments in marketing and the seller wants more sales before it invests in marketing. This situation can be a “chicken and egg dilemma” and may represent an obstacle to negotiation. The proposed contingent agreement analysed in detail below has the objective of addressing this particular issue, and will regard a progressive marketing investment scheme based on sales performance, thereby also demonstrating some of the features proposed in section 2 above.

In addition to the choice for product, this research focuses on a long term international commercial relationship. In practice, this sort of supply agreement requires continued interaction between the parties. This required interaction is argued by negotiation scholars to be a necessary factor for the viability and usefulness of the use contingent agreements (THOMPSON 2008 and LEX and SEBENIUS 1986). In addition, the investment of time and effort in a well negotiated agreement may only make sense in long term commercial relationships. In fact, the export of goods to a target market is only the first stage of an internationalization process. Therefore, the continued interaction between parties is to be expected in international sales, providing further reason for negotiation and use of contingent agreements.

### 3.3. The legal regime for the international contract of sale of goods in between Portugal and Brazil

It is not the intent of this paper to exhaustively discuss all the possible legal restraints present in the relevant legal systems regarding an international contract of sale. Rather, because this paper focuses on the negotiation and closing of contingent agreements as a way to avoid legal disputes, the legal analysis simply defines the legal context behind the international contract of sale, reviews the legal basis, protecting the use of contingent agreements, and identifies possible limitations and threats.

A detailed legal analysis, with the development and selection of legal arguments, becomes relevant only when parties come closer to an impasse. Therefore, the application of any legal system and its effects on the contingent agreement become secondary and depends on a breach of the contract by one of the parties, related to the “rights approach” discussed above in section



2.3.2. Assuming parties are acting in good faith and are willing to respect the decision and commitments made during the negotiation of the contingent agreement, for the purpose of this paper there is no need for a detailed legal analysis.

The contract of sale from a Portuguese exporting company to a Brazilian buyer is an international business deal. This means that the buyer and seller have their places of business in two different countries with different legal systems. Unlike local business deals<sup>26</sup>, in international deals parties have the option to choose the law to govern their contract of sale. In this respect, parties can: i) choose the law of the buyer, in this case Brazilian law; ii) choose the law of the seller, in this case Portuguese law; iii) choose a neutral law, meaning a law of third country or an international law<sup>27</sup>, and finally; iv) choose nothing and depend on default rules of private international law<sup>28</sup> (or conflicts of laws), which according to a set of rules will define one of the conflicting domestic laws, namely Brazilian or Portuguese law, to be applied to the contract. This situation is one of the reasons that justifies the use of contingent agreements as argued in section 2.2.3 above.

This research assumes that most SMEs are legally unsophisticated and will not opt for international arbitration or choose a law to govern their international contract of sale. According to CISG analysis (CUNIBERTI 2006), the vast majority of international buyers and sellers do not address the issue of the law governing their contracts. This supports the argument that managers consider the law mainly as a remedy. On some occasions parties even fail to draft a contract. Such oversight can result in poorly drafted and incomplete contracts of sale, leading to future legal disputes. By avoiding legal aspects of the deal, and consequently lacking proper negotiation and proper contract drafting, including the use of contingent agreements, SMEs increase the probability of a legal dispute and higher exposure to risks.

### 3.3.1. The CISG and Brazil's recent adoption

The 1980 Convention on Contracts for the International Sale of Goods (CISG) is part of Uniform International Sales Laws. Before the CISG, International sales have previously been the subject of the Hague Conventions of 1964. The CISG, or Vienna Convention, was prepared by

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<sup>26</sup> Local deals are under the jurisdiction of the local court. There is an option to opt for arbitration in local business deals and choose a different law than the local law. However, this should not be appropriate and may create all sorts of problems. Anyway this options are not advisable for SMEs without the proper professional support, considering their legal unsophistication argued through this paper.

<sup>27</sup> International law means and it is here represented by a developed international legal system comprised by International Conventions on several subjects such as International Arbitration (New York Convention) and Contract Law (The CISG for example). The application of these Conventions is conditional on the adoption of such legal texts by the respective countries. This is the case of the recent adoption of Brazil for the text of the CISG.

<sup>28</sup> *"The underlying concept of modern private international law remains that all legal relationships have a basis or a seat (Sitz) in a national law and are thus all domestic in nature, a view associated with the teachings of F Von Savigny (1779-1861) in the German Historical School of early 19th century, which saw all law as statist and therefore territorial. Within this approach, he proceeded to formulate a set of (in his view) objective conflict rules aimed at reaching automatically the applicable national law in cases with international aspects, therefore in cases that could conceivably be covered by more than one domestic law. Such law would then have to be applied by any court whenever, in preference to its Lex fori."* DALHUISEN 2007 Chapter I, Part II, Section 2.1.1.

UNICTRAL<sup>29</sup>, the UN commission on International Trade Law. The CISG has been a success in terms of harmonizing international law with respect to international sale of goods. It has been adopted by more than 80 states, representing more than 80% of total international commerce (CASTELLANI 2013).

On October 16, 2013, Brazil's Senate approved the text of the CISG, which after its promulgation and deposit with the Secretary General of the United Nations, will become effective on April 1st 2014. Although the reasons that motivated Brazil at this moment to adopt the CISG are not completely clear, it may be argued as a necessary step to harmonize Brazil's trade laws and foster international trade relations. This may be a consequence of the recent ascension of Brazil as one of the top economies in the world and a major supplier of goods to China and other emergent economies. In fact, the Brazil's major trade partners are all contracting states of the CISG: China, United States, Germany, and the Mercosur partners.

Despite its success in terms of adoption by countries, legal scholars criticized CISG text and provisions. There are doubts regarding the benefits of the CISG for Brazilian and foreign companies. In general, promoters of the CISG argue for the legal certainty and harmonization that CISG can bring to trade relations<sup>30</sup>. Critics of the CISG argue that its incompleteness and lack of balance favours the buyer<sup>31</sup>.

Portugal is not a signatory of the CISG. According to the rules defined in article 1 of the CISG legal text, which determines the applicability of the CISG to contracts of sale of goods between parties whose places of business are in different states, there are two possibilities: i) it will be applicable when the states are contracting states, which is not the case because Portugal is not a contracting state, or ii) it will be applicable when the rules of private international law lead to the application of the law of a contracting state, Brazil in this case. In conclusion, the CISG will only be applicable in the second case, as part of Brazilian Law.

Compared to an exclusive application of Brazilian law, the CISG is expected to have lower transaction costs and less risks for Portuguese SMEs. In any case, the CISG was designed to address the particularities of an international sale. On the other hand, both Brazilian and Portuguese law have domestic approaches that are inappropriate for the context of an international sale.

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<sup>29</sup> The United Nations Commission on International Trade Law. The core legal body of the United Nations system in the field of international trade law. A legal body with universal membership specializing in commercial law reform worldwide for over 40 years. UNCITRAL's business is the modernization and harmonization of rules on international business. Visit their webpage at: <http://www.uncitral.org/uncitral/en/index.html>.

<sup>30</sup> For an opinion in favour of the CISG see CASTELLANI 2013.

<sup>31</sup> *"Application of the Vienna Convention alone will not guarantee uniformity as it covers the subject of international sale only partially and notably not the aspect of the transfer of ownership which is the true objective of all sales contracts. In any event, there will remain diversity in its interpretation and certainly in its supplementation where, for the one, reference is made to the widely varying good faith notion and, for the other, to private international law rules..."*. DALHUISEN, 2007. Chapter II, Section 2.3, Item 2.3.2, page 404.

Despite legal criticisms, the adoption of the CISG by Brazil is a fact and will in the majority of the cases, by default, affect trade relations of foreign companies exporting to Brazil. Even legal critics of the CISG acknowledge its benefits for legally unsophisticated parties. Review and understanding it is therefore a necessary step in the process of negotiation and drafting of contracts of international sale and the respective contingent agreements. The next section provides a brief legal analysis of the provisions of the CISG, considered in combination with the application of the Brazilian law.

### 3.3.2. Brazilian and Portuguese Contract Law

The CISG is part of the Brazilian law and is applicable to international contracts of goods with Brazilian parties. However, the CISG does not deal with some aspects of a contract of sale, such as the transfer of title, and local Brazilian law will apply as complementary. For this reason, this section will include details regarding the CISG, the Brazilian law, and Portuguese law.

The principle behind contract law is to enforce and protect the private definition of contracts between parties; in other words, giving the force of law to what parties have defined in their contracts, including contingent clauses. This party autonomy or freedom of contract is one of the most respected principles in Contract Law and is promoted by the majority of the legal systems around the world. Exceptions to this principle by legal courts are based on public law arguments, which should be limited and of restricted use. Therefore, parties should design detailed Contracts for their international deals, including provisions in the case of occurrence of future and uncertain events, which is the goal of Contingent Contracts.

Portuguese law, Brazilian law, and the CISG promote party autonomy as one of the main principles of Contract Law. The Portuguese Law deals with Contract Law in the Civil Code, Chapter II, under a form of source of obligations, and in its article 405º nº 1 establishes the principle and describes the freedom of contract, stating that parties, under the limits of the law, have the freedom to define the content of their contracts, freely celebrate contracts and define their clauses. The expression “limits of the law”, which is related to public interest and policy, should not affect the validity of a commercial contingent clause unless it is something expressly abusive, such as clauses overriding labour, consumer, or competition law. Clear violations of import restrictions and quotas may also represent limitations to the scope of the contingent contracts and possibly reducing its enforceability and legal power.

Brazilian law in Article 421 of the Civil Code also promotes freedom of contract, but states the limitation in terms of the principle “social function of the contract”. This is an undefined term in Brazilian law and its meaning depends on the circumstances. According to Brazilian legal doctrine<sup>32</sup>, it can refer to the contract equilibrium, meaning the balance of parties’ power. In this sense, in a contract of sale a clause that determines that the price to be fixed exclusively by one

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<sup>32</sup> See SANDRI, 2011.

of the parties is considered a violation of this principle<sup>33</sup>. In addition, when regulating the contract of sale, Brazilian law Article 485 determines that the price can be determined by a third party, which should be the case when using the contingent contract of dynamic pricing proposed above.

The CISG, as of April 1<sup>st</sup> 2014 part of the Brazilian law, also protects and promotes the principle of party autonomy. In Article 6 states that the parties to a contract *"may exclude the application of this Convention or ... derogate<sup>34</sup> from or vary the effect of any of its provisions."*<sup>35</sup> According to CISG doctrine<sup>36</sup>, the CISG promotes freedom of contract. The United States Federal court confirms that interpretation<sup>37</sup>. Therefore, except the possible limitations of scope briefly explained above, the relevant legal regimes consecrate the principle of freedom of contract, in principle securing the validity of contingent clauses determined by parties.

There are also specific legal regulations regarding contingent contracts and contracts of sale in both national laws that deserve some attention. Brazilian Law protects the celebration and performance of contingent contracts. In the Civil Code, Section VII, Article 458 states that when one of the parties assumed the risk of the occurrence or not of a future event, the other party is obligated to perform as long as the benefiting party did not caused the outcome intentionally or under tort. Note that if a party intentionally caused the outcome for its own benefit, the use of contingent contract is not appropriate. Apart from the fact that one of the parties had control over the outcome, which is not appropriate, that party also had the incentive to perform that way damaging the other party. This sort of contract is abusive and it is not recognized and enforced by the Brazilian law. On the other hand, in the progressive marketing budget example discussed above, although one of the parties has some level of control over the future outcome, it has an incentive to perform and not damage the other party.

Portuguese law is brief when dealing with contingent contracts and, different than the Brazilian law, does not reserve a whole section to regulate this type of contract. It considers contingent contracts as atypical contracts (GONÇALVES 1995), which should be recognized and protected under the principle of party autonomy discussed above. When regulating the contract

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<sup>33</sup> The Brazilian Civil Code, Title V, Chapter I, Section I, Article 489. *Nulo é o contrato de compra e venda, quando se deixa ao arbítrio exclusivo de uma das partes a fixação do preço.*

<sup>34</sup> FELEMENGAS, Jonh in The United Nations Convention on Contracts for the International Sale of Goods: Article 7 and Uniform Interpretation: *"The exclusion of CISG would most often result from the choice by the parties of the law of a non-Contracting State or of the domestic law of a Contracting State to be the law applicable to the contract. Derogation from the Convention would occur whenever a provision in the contract provided a different rule from that found in CISG"*. available at Pace Review of the Convention on Contracts for the International Sale of Goods (CISG), Kluwer Law International (2000-2001) 115-265

<sup>35</sup> United Nations Convention on Contracts for the International Sale of Goods, 1980 (CISG) – Article 6.

<sup>36</sup> MACHON, Jonh P., Guide for Managers and Counsel - Applying the CISG Guides for Business Managers and Counsel, Revised May 2010.

<sup>37</sup> U.S. District Court, Northern District of Illinois, Eastern Division in *Ajax Tool Works, Inc. v. Can-Eng Manufacturing* (Northern District, Illinois, 29 January 2003). "The CISG does not pre-empt a private contract between parties; instead, it provides a statutory authority from which contract provisions are interpreted, fills gaps in contract language, and governs issues not addressed by the contract." available for consult at CISG database website <http://cisgw3.law.pace.edu/cases/030129u1.html#cd>

of sale, the Civil Code in article 881 specifically mentions the use of contingent terms regarding sale of future goods or undefined title, enforcing the performance unless parties refuse the contingent nature of the contract. This subject of contingent nature of contracts is dealt with in more detail in respect to insurance contracts, which should be applicable to other contracts if there is no other provision. According to Portuguese doctrine (FREITAS 2013), as long as the contingent nature of the contract does not represent a sort of game, which is considered illegal and cannot be contracted, contingent contracts should be recognized and protected by the Portuguese legal system.

Regarding the CISG, according to Article 4 the Convention “*governs only the formation of the contract of sale and the rights and obligations of the seller and the buyer arising from such a contract.*” and it is not expressly concerned with the issue of validity of the contract or any of its provisions. However, when negotiating and drafting their contingent contracts parties should pay attention to some provisions of the CISG, which may be conflicting with their intent under the contingent clauses. An important concern relates to the definition of what represents a fundamental breach, which is dealt by article 25. Parties should modify this provision accordingly and clearly define the case of a breach of the contract when a party does not fulfil his obligation derived from a contingent contract. All the remedies defined in the CISG apply when the breach of a contract is recognized, including communication and other requirements.

For example, article 50 goes against the purpose of the contingent contract of dynamic pricing proposed and discussed earlier. This article gives the right for the buyer to exclusively reduce the price consonant non conformity of the goods. This article should be derogated by specific and different provisions in the contract. This is another fundamental argument in favour of a well detailed contract, describing all the conditions negotiated by the parties, avoiding the default application of legal texts that may play against parties’ intent.

It is possible to conclude from this legal analysis, in principle all the relevant legal system to a contract of sale from Portugal to Brazil will recognize and protect contingent contracts determined in the contract of sale. However, there are specific regulations concerning contracts of sale that may represent limitations of scope and possible threats to the enforceability of this contract in the case of legal dispute. As mentioned, the enforceability of contingent clauses will only be discussed in cases of legal dispute and should therefore be a subsidiary concern for business managers when negotiating and drafting their contracts. The legal knowledge must be focused on translating with clarity and objectivity the contingent clauses negotiated by the parties, leaving no room for doubts regarding the obligations of each party when the contingency crystalizes.

#### 4. PROPOSED CONTINGENT AGREEMENTS FOR INTERNATIONAL SALES OF GOODS FROM PORTUGAL TO BRAZIL

These proposed examples of contingent contracts below are very simple and serve only to demonstrate the structuring and possible applications of these agreements in the context of the

international sale of goods from Portugal to Brazil. These examples are not by any means a complete representation of the potential behind the use of contingent agreements. As mentioned before, the technical level and benefits of contingent agreements depend on the negotiator's knowledge of advance negotiation integrative strategies in combination with industry knowledge, reflecting their capabilities to create options for mutual gains (FISHER, URY and PATTON 1991) and allocate risk.

It is also important to keep in mind that contracts are dynamic in nature and should evolve throughout the commercial relationship, requiring constant updates. An outdated contract may be just as bad as having no contract at all. In legal disputes, it is usual for parties to, arguing mistake of intent, contest the validity of outdated clauses. This means that what parties are doing in reality is in conflict with the text of the contract, which undermines its validity and reduces its effectiveness. Thus, keeping the contract up to date, including new terms according to new information about the commercial operation, is fundamental for its efficacy. Moreover, the constant updating can represent an opportunity for parties to make use of post-settlement negotiation strategies<sup>38</sup>.

#### 4.1. Dealing with uncertainties of quality in agricultural products.

This contingent agreement will be dedicated to the category of agricultural products, by far the first ranking category of products exported from Portugal to Brazil. This category of goods, by nature, is sensitive to weather conditions and significant variations in quality are common. Variations in quality are not in the interest of either of the parties. However, in this case it is unavoidable and it may block the deal if the commercial relation is new and lacks trust. In this sense, parties should bet on their expectations and avoid discussions about the future quality of the products, which is uncertain, creating incentives to overperform.

The contingency will regard the quality of the product in the future and should be represented by a price formula with levels of quality predefined by parties, with an objective procedure to analyse and set the quality, which can be done by the negotiating parties in conjunction or by a third party. The price formula may also include an index for exchange rates, interest rates and/or other indexes used in the market, therefore managing risk and protecting parties' interests.

In addition this sort of contingent agreement may include other obligations serving as trade-offs in between the parties, adding issues to the table<sup>39</sup>, and facilitating the negotiation process. For example, below a certain level of quality the buyer may have the right to refuse delivery and claim a penalty for damages, which can be discounted from the next instalments or under other conditions of payment. In exchange, the buyer should provide storage and help the

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<sup>38</sup> "PostSettlement settlement is a negotiation strategy for expanding the pie in which negotiators reach an initial settlement that both agree to but spend additional time attempting to improve upon". THOMPSON 2013.

<sup>39</sup> Adding issues to the table is a negotiation strategy proposed by several negotiation Scholars. See "Unbundle the issues" as an effective Pie-expanding strategy THOMPSON 2013, and LAX and SEBENIUS 1986.

seller to resell the goods to another buyer, avoiding higher losses. Incentives for better performance are present here as well in form of a trade off. The seller guarantees the quality for an exchange of security that the buyer has no incentive to abuse, empowering trust in between the negotiating parties. In the absence of such a contingent agreement, there are no incentives for the seller nor to the buyer to perform, and as a result both the buyer and the seller would be exposed to higher risks.

Considering a contract of supply, the potential for variation in quality makes it very difficult for parties to negotiate and determine the price. Naturally, the price should directly reflect the quality of the goods shipped and at the time of the delivery, thus becoming dynamic. They may define the price just before each sale without any contingent agreement defining the terms for it, but for the arguments presented above this would not be optimal. A contract of supply with this sort of contingent agreement may assure the seller a buyer for its products as long as the seller manages to maintain the promised quality or improve it, in this case getting compensated for it. This would possibly allow the parties to organize a form of financing in between them, avoiding the use of banks for financing operations, consequently reducing transaction costs. For security, banks may provide a guarantee, which should cost much less.

So instead of determining a fixed price at the time of the shipment, parties may use a contingent agreement and bet over the quality of the goods. This would be done through a clause defining in detail how to measure the quality of the goods and how the price is fixed. For example, quality of fruit is usually evaluate by the calibre and random sampling. As mentioned before, the definition of the procedure and characteristics to consider when measuring the quality of the goods must be very detailed and leave little to interpretation. Most of the time, procedures to measure quality involve a third party that is impartial. This would makes things simpler, but with costs associated.

The use of third party may be subsidiary and only used in some specific cases. Imagine the following procedure. The seller, respecting the procedure determined in the contract, will have the first call when selecting and packing the goods, to attribute a quality type and fix the price accordingly to the contingent clause. When receiving the goods, if the buyer following the same procedure denies the quality attributed by the seller, parties then should call for a third party to solve the impasse. This will certainly reduce the cost and maintain the same level of fairness. It is good to note that this is not an infringement of the Brazilian law, which declares void the contract in the case of the price to be fixed exclusively by one of the parties, legal subject discussed with more detail in section 3.3.2.

This contingent agreement establishing a dynamic price scheme also solves issues of trust by creating incentives to perform through the use of premium or punitive clauses, avoiding discussions over a future and uncertain event, namely, the quality of agricultural goods (including packing) at the time of delivery. Remember that delivery of agricultural products in international sales occurs after harvesting, packing, export and import clearing, and international and

domestic transporting. The opportunities and characteristic that justify the negotiation and use of contingent agreements are here present, and as demonstrated above by this simple example, its features may accommodate some of the complexities of this international sale of agricultural products. From this starting point, it is up to practitioners in this area, which have the necessary industry knowledge, based on their previous experiences, to design better and more advance contingent agreements.

#### 4.2. A progressive marketing budget<sup>40</sup> facility as an incentive to perform

This contingent agreement will be dedicated to alimentary products, which are fifth in ranking of products exported from Portugal to Brazil, thus of significant importance. According to the classification and description of this category, one may assume that the vast majority of alimentary products exported to Brazil are consumer goods. And the success of consumer goods is heavily dependent on marketing investments, especially in this era of the domination of the big retailers. Therefore, marketing investments is a sensitive issue. During the negotiation of an international sale, one may clearly imagine that the seller is reluctant to commit to marketing investments without previously testing the buyer and the market. Especially considering that at this point their commercial relationship lacks trust.

Usually the arguments about the marketing budget are controversial. Without trust, the seller has no assurance that his investment will be well applied and future sale will reflect his expectations. Moreover, the buyer is in another country making it difficult and expensive to track the evolution of sales operations. The buyer on the other hand, with different expectations and more information about the market, argues that in order to improve sales more marketing investments are needed, and is reluctant to invest time and effort in the seller's products without such investments.

Pegging the marketing budget offered by the seller to the sales performance of the buyer, by using parties' expectations during the negotiation process, can protect the seller's marketing investments and incentivize the buyer to overperform and seek more sales. As per the example in section 4.1, the contingent agreement here may contain additional conditions in order to create the right incentives and protection. For example, it may include provisions for future tranches of marketing budget in the case of participation in events, showing on local retailers' sale flyers, and other marketing promotions to boost sales.

One form of boosting sales is to incentivize the sales force of the buyer. In this sense, all sorts of incentives, which have not to be monetary, may be created through the use of a contingent agreement between parties. Besides being pegged to sales performance, the marketing budget may depend on other qualitative metrics. For example, the seller may provide all sorts of training and additional conditions to the buyer's sales force. It is assumed here that

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<sup>40</sup> In this respect see the example in "*The Principles Applied: A Budget negotiation.*" Chapter 8 – LAX and SEBENIUS 1986.



managers will have the proper knowledge and tools to design such clauses and create the right incentives.

Again these activities may be already done in practice, but it is not the objective of this paper to innovate in terms of marketing practices. Instead, this paper advocates that parties use all of these possible conditions that are dependent on future and uncertain events, which possibly serve as a marketing practice to boost sales, using them as trade-offs and as new issues to the deal, to design beneficial contingent agreements.

## 5. CONCLUSION

This thesis starts from the argument that international business deals bring additional complexities to the negotiation table and increase the level of risk, especially for SMEs, which are less legally sophisticated companies. In the search for a practical and pragmatic solution, the negotiation literature regarding contingent agreements was reviewed. The use of a legal perspective, enabled the identification, selection and further development of contingent contract features with the goal of facilitating the negotiation process and managing the additional risks. It was also argued that the distance, different market practices and cultural differences intrinsic to international deals while adding complexity and risks also can also create opportunities for parties to develop creative agreements, including the use of contingent agreements.

The research suggests that the creation of incentives and the alignment of interests through negotiation leading to contingent agreements is likely to mitigate problems of lack of trust. The use of contingent agreements facilitates international contracts promoting commerce and access of SMEs to international markets. This research also demonstrated that negotiation leading to contingent agreements serves as a risk management facility, facilitating the solution of and avoiding disputes, and improving the quality of business deals.

Focused on the recent growth of exports from and internationalization of Portuguese companies to Brazil, and the recent Brazilian adoption of the CISG, this paper proposes the possible structuring of two contingent agreements for two categories of products, agricultural and alimentary. Through this example, this research attempts to demonstrate the potential benefits resulting from negotiation and use of contingent agreements as a solution for distrust and a means of risk management, both to address additional complexities and risks of international deals. It was argued that once creative deals based on parties differences are accepted as a means to achieve the creation of incentives and identification and allocation of future risks, the practical implications and benefits of contingent agreements can be significant and improve the quality of deals.

In terms of sources of data, this paper reviewed the negotiation literature regarding the structuring of contingent agreements and combined it with legal research regarding the basis of contractual law and the party autonomy principle. The legal research focused on the case of international sale of goods from Portugal to Brazil, as a promising context for proposing

contingent agreements. Of course, a thorough legal analysis of all the risks and issues related an international sale of goods was not attempted. The negotiation and use of contingent agreements may serve all sort of businesses situations; however, its efficiency and legal strength will depend on parties integrative negotiation and legal competences in each specific case.

The topic has potential practical benefits while maintaining its simplicity, therefore becoming a feasible tool not only for large and sophisticated corporations but also for the unsophisticated SMEs. It is these companies which due to the economic crisis have recently been forced to look to international markets and the risks and complexities they bring. This research has relevant and practical implications for business managers of companies that are internationalizing to external markets. If business managers of these SMEs are able to understand the basic protections of contractual law and dedicate effort to negotiate and use contingent agreements, it is likely that they will increase their chance of celebrating more and better international deals.

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